

*transfer.* FC is a foreign corporation that is wholly owned by A, a nonresident alien who is resident in Country C. FC makes a gratuitous transfer to a foreign trust, FT, that has no other assets. FT immediately makes a gratuitous transfer in the same amount to A's daughter, B, who is a resident alien. Under paragraph (c)(1) of this section, B must treat the transfer as a transfer from FC that is subject to the rules of paragraph (a)(2) of this section. Under paragraph (a)(2) of this section, B must treat the transfer as a dividend from FC unless she can establish to the satisfaction of the Commissioner that, for purposes of the tax laws of Country C, A treated (and reported, if applicable) the transfer as a distribution to himself and a subsequent gift to B and that B timely complied with the reporting requirements of section 6039F, if applicable. The alternative rule in paragraph (c)(2) of this section would not apply as long as the United States tax computed under the rules of paragraph (a)(2) of this section is equal to or greater than the United States tax that would be due if the transfer were treated as a distribution from FT.

*Example 3. Accumulation distribution from trust to which foreign corporation made gratuitous transfer.* FC is a foreign corporation that is wholly owned by A, a nonresident alien. FC is not a passive foreign investment company (as defined in section 1297). FC makes a gratuitous transfer of 100X to a foreign trust, FT, on January 1, 2001. FT has no other assets on January 1, 2001. Several years later, FT makes a gratuitous transfer of 100X to A's daughter, B, who is a United States resident. Assume that the section 668 interest charge on accumulation distributions will apply if the transfer is treated as a distribution from FT. Under the alternative rule of paragraph (c)(2) of this section, B must treat the transfer as an accumulation distribution from FT, because the resulting United States tax liability is greater than the United States tax that would be due if the transfer were treated as a transfer from FC that is subject to the rules of paragraph (a) of this section.

*Example 4. Transfer from trust that is treated as owned by United States citizen.* Assume the same facts as in *Example 3*, except that A is a United States citizen. Assume that A treats and reports the transfer to FT as a constructive distribution to himself, followed by a gratuitous transfer to FT, and that A is properly treated as the grantor of FT within the meaning of § 1.671-2(e). A is treated as the owner of FT under section 679 and, as required by section 671 and the regulations thereunder, A includes all of FT's items of income, deductions, and credit in computing his taxable income and credits. Neither paragraph (c)(1) nor paragraph (c)(2) of this section is applicable, because the ex-

ception in paragraph (c)(3) of this section applies.

*Example 5. Transfer for less than fair market value.* FC is a foreign corporation that is wholly owned by A, a nonresident alien. On January 15, 2001, FC transfers property directly to A's daughter, B, a resident alien, in exchange for 90X. The Commissioner later determines that the fair market value of the property at the time of the transfer was 100X. Under paragraph (d)(2)(i) of this section, 10X will be treated as a purported gift to B on January 15, 2001.

(h) *Effective date.* The rules of this section are generally applicable to any transfer after August 10, 1999, by a partnership or foreign corporation, or by a trust to which a partnership or foreign corporation makes a gratuitous transfer after August 10, 1999.

[T.D. 8831, 64 FR 43278, Aug. 10, 1999, as amended by T.D. 8890, 65 FR 41334, July 5, 2000]

#### § 1.672(f)-5 Special rules.

(a) *Transfers by certain beneficiaries to foreign grantor—(1) In general.* If, but for section 672(f)(5), a foreign person would be treated as the owner of any portion of a trust, any United States beneficiary of the trust is treated as the grantor of a portion of the trust to the extent the United States beneficiary directly or indirectly made transfers of property to such foreign person (without regard to whether the United States beneficiary was a United States beneficiary at the time of any transfer) in excess of transfers to the United States beneficiary from the foreign person. The rule of this paragraph (a) does not apply to the extent the United States beneficiary can demonstrate to the satisfaction of the Commissioner that the transfer by the United States beneficiary to the foreign person was wholly unrelated to any transaction involving the trust. For purposes of this paragraph (a), the term property includes cash, and a transfer of property does not include a transfer that is not a gratuitous transfer (within the meaning of § 1.671-2(e)(2)). In addition, a gift is not taken into account to the extent such gift would not be characterized as a taxable gift under section 2503(b). For a definition of United States beneficiary, see section 679.

(2) *Examples.* The following examples illustrate the rules of this section:

*Example 1.* A, a nonresident alien, contributes property to FC, a foreign corporation that is wholly owned by A. FC creates a foreign trust, FT, for the benefit of A and A's children. FT is revocable by FC without the approval or consent of any other person. FC funds FT with the property received from A. A and A's family move to the United States. Under paragraph (a)(1) of this section, A is treated as a grantor of FT. (A may also be treated as an owner of FT under section 679(a)(4).)

*Example 2.* B, a United States citizen, makes a gratuitous transfer of \$1 million to B's uncle, C, a nonresident alien. C creates a foreign trust, FT, for the benefit of B and B's children. FT is revocable by C without the approval or consent of any other person. C funds FT with the property received from B. Under paragraph (a)(1) of this section, B is treated as a grantor of FT. (B also would be treated as an owner of FT as a result of section 679.)

(b) *Entity characterization.* Entities generally are characterized under United States tax principles for purposes of §§1.672(f)-1 through 1.672(f)-5. See §§301.7701-1 through 301.7701-4 of this chapter. However, solely for purposes of §1.672(f)-4, a transferor that is a wholly owned business entity is treated as a corporation, separate from its single owner.

(c) *Effective date.* The rules in paragraph (a) of this section are applicable to transfers to trusts on or after August 10, 1999. The rules in paragraph (b) of this section are applicable August 10, 1999.

[T.D. 8831, 64 FR 43280, Aug. 10, 1999, as amended by T.D. 8890, 65 FR 41334, July 5, 2000]

**§ 1.673(a)-1 Reversionary interests; income payable to beneficiaries other than certain charitable organizations; general rule.**

(a) Under section 673(a), a grantor, in general, is treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or income if, as of the inception of that portion of the trust, the grantor's interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years commencing with the date of transfer of that portion of the trust. However, the following types of reversionary interests are excepted from the general rule of the preceding sentence:

(1) A reversionary interest after the death of the income beneficiary of a trust (see paragraph (b) of this section); and

(2) Except in the case of transfers in trust made after April 22, 1969, a reversionary interest in a charitable trust meeting the requirements of section 673(b) (see §1.673(b)-1). Even though the duration of the trust may be such that the grantor is not treated as its owner under section 673, and therefore is not taxed on the ordinary income, he may nevertheless be treated as an owner under section 677(a)(2) if he has a reversionary interest in the corpus. In the latter case, items of income, deduction, and credit allocable to corpus, such as capital gains and losses, will be included in the portion he owns. See §1.671-3 and the regulations under section 677. See §1.673(d)-1 with respect to a postponement of the date specified for reacquisition of a reversionary interest.

(b) Section 673(c) provides that a grantor is not treated as the owner of any portion of a trust by reason of section 673 if his reversionary interest in the portion is not to take effect in possession or enjoyment until the death of the person or persons to whom the income of the portion is regardless of the life expectancies of the income beneficiaries. If his reversionary interest is to take effect on or after the death of an income beneficiary or upon the expiration of a specific term of years, whichever is earlier, the grantor is treated as the owner if the specific term of years is less than 10 years (but not if the term is 10 years or longer).

(c) Where the grantor's reversionary interest in a portion of a trust is to take effect in possession or enjoyment by reason of some event other than the expiration of a specific term of years or the death of the income beneficiary, the grantor is treated as the owner of the portion if the event may reasonably be expected to occur within 10 years from the date of transfer of that portion, but he is not treated as the owner under section 673 if the event may not reasonably be expected to occur within 10 years from that date. For example, if the reversionary interest in any portion of a trust is to take effect on or after the death of the